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November 2, 1994

VIA HAND DELIVERY

Mr. William F. Caton
Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: Ex Parte Presentation in MM Docket 92-266

Dear Mr. Caton:

Pursuant to 47 C.F.R. § 1.1206, KMR Media, Inc. ("KMR"), through undersigned counsel, submits this original and one copy of a letter disclosing written and oral ex parte presentations in the above-captioned proceeding.

On November 2, 1994, the undersigned, Robert Thompson, President of KMR, and Ralph Rosella attended five meetings with William Johnson, Jill Luckett, Mary McManus, Maureen O'Connell and Lisa Smith, respectively. The meetings dealt with the maximum permissible rates for commercial leased access channels, including matters set forth in the attached written presentation of KMR. A copy of the attached written presentation was given to each of the foregoing individuals, other than Ms. Smith, at the meetings on November 2, 1994.

Very truly yours,

MILLER, CANFIELD, PADDOCK AND STONE

By

Tillman L. Lay

Enclosure

cc: William Johnson, Esq.
Jill Luckett, Esq.
Mary McManus, Esq.
Maureen O'Connell, Esq.
Lisa Smith, Esq.

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KMR MEDIA, INC.

REVISING THE LEASED ACCESS RULES TO MEET THE CONGRESSIONAL GOAL OF PROMOTING LEASED ACCESS PROGRAMMING: BASE RATES ON HISTORICAL AND MARKETPLACE EVIDENCE AND REDUCE INCENTIVES FOR OBSTRUCTION AND DELAY BY OPERATORS

I. Introduction: The Issues Before the Commission

Leased access programmers serve an important purpose under the Cable Act: They ensure that a cable operator does not exercise complete bottleneck editorial control over all multichannel video programming delivered to the home. This purpose is not being met, however, because the Commission's current leased access rules, (at least as they are being interpreted by cable operators) permit operators to charge prohibitively high rates. Furthermore, even if the Commission revises the implicit fee formula to address this problem, operators will continue to impede the development of the leased access industry by demanding onerous and unreasonable terms of carriage.

The Commission must bear in mind that, like all other new programmers, leased access providers need definite and reasonable rules to promote investment, growth and development in the industry. On one hand, leased access programmers need the protections of the Cable Act and the Commission's rules because they do not have the advantages of being affiliated with MSO's or large, established programmers. But at the same time, they should not be discriminated against. Therefore, if the Commission opts to establish "going forward" incentives to foster non-leased access programming development, operators should be given the same incentives to carry leased access programming as they are given to carry other types of new programming.

II. Obstacles Facing Leased Access: The Example of KMR Media

KMR Media, Inc. ("KMR") is a new venture that desires to lease a 24-hour channel to deliver real estate information and advertising to approximately 600,000 Cablevision subscribers in Western Long Island. Robert Thompson, the founder and principal investor in KMR, has an established reputation in the Long Island business community and extensive experience in fields allied to the communications industry, having founded a successful regional magazine ("516 Magazine") and established a successful advertising agency. Mr. Thompson's other credentials include service as President of his local Chamber of Commerce and selection as Nassau County's Businessperson of the Year. KMR's potential investors include an individual experienced in owning and operating similar channels on major cable systems in Canada. Those channels use state-of-the-art multimedia software developed and owned by another potential investor. Similar ventures are already operating in nine states.

Despite the proven track record of the concept, the directly relevant experience of the principals, and the recent upswing in the Long Island real estate market, Cablevision has refused to enter into serious talks with KMR. KMR has been attempting to negotiate access on Cablevision's systems for nearly a year and has met only with delay, unreasonable demands and outright rejection.

KMR first approached Cablevision informally in November 1993, and followed up that contact with a brief written proposal later that month. During the first informal conversations, Cablevision provided KMR with its rate card, and stated that it might be possible to negotiate a discount.

Cablevision responded to KMR's proposal with a form letter enclosing its leased access rate card and asking for additional information, which KMR promptly provided. A month later, Cablevision had not replied to KMR's information submission, nor to literally dozens of telephone calls, forcing KMR to write again.[1]

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[1]Not only has Cablevision been unusually slow in responding to KMR's attempts to negotiate, but KMR has had to provide sample tapes of its programming on two separate occasions because Cablevision misplaced the tape KMR had provided earlier.

Finally, in April 1994, Cablevision stated in a letter to KMR that it was interested in the proposal and wanted to discuss it further, but demanded a letter of credit or other documentation establishing KMR's financial resources as a pre-condition to further negotiations. The parties met and Cablevision again provided its rate card, and again stated that it might offer a discount. During this period, KMR attempted to determine exactly what level of financial commitment would satisfy Cablevision's concerns but was told only "As much as you can get."

Cablevision has also indicated that it believes KMR's programming would be home shopping and thus would have to pay a higher rate than advertiser-supported programming, although it has never explained its reasoning for this conclusion. KMR, however, has always assumed that it would not be considered a home shopping channel, and used Cablevision's lower non-home shopping rate in preparing its business plans.

Cablevision's rate card quotes rates of $1,199.67 per hour during prime time and $693.45 per hour at all other times. This amounts to over $20,000 per day, or over $7,333,000 per year. Assuming there are about 600,000 subscribers on Cablevision's Western Long Island systems, this comes to over $1.00 per subscriber per month. Cablevision has never explained the basis for its calculations, although KMR has asked for that information.

In any case, after additional conversations in which Cablevision essentially stated that its rate was negotiable -- but apparently no discount is being offered now -- and repeated its demand for some type of security or financial guarantee, KMR made an offer to Cablevision of $0.05 per subscriber per month in August 1994. This would have amounted to approximately $30,000 per month, and was comparable to amounts being paid to Canadian operators. Cablevision failed to respond to this offer, so KMR again contacted Cablevision and was told that a written counterproposal would be forthcoming. When no counterproposal was received, KMR wrote to Cablevision once more. Finally, in October 1994, Cablevision responded, rejecting KMR's offer as not "serious," and stating "We are prepared to enter into such discussions at such time as your client extends a fair offer for the value of a full-time channel on all of Long Island." Cablevision also repeated its demand for some form of security as a condition to further talks.

KMR is now attempting to reinitiate the negotiations by asking Cablevision for the details of its implicit fee calculation, in the hope that such information might provide a basis for bringing the parties closer together, but has concluded that this is a vain hope because it does not appear that Cablevision is interested in serious negotiations.

III. The Pernicious Effects of the Current Rules on the Development of Leased Access

KMR's experience makes it clear that the uncertainty and exorbitant rates stemming from cable operators' interpretations of the implicit fee formula and the leased access rules are stifling leased access programmers' ability to invest in new programming and facilities. KMR cannot establish a business with proven potential because Cablevision simply prefers not to deal with KMR, never mind the intent of Congress in creating leased access. The Commission can correct this to some extent by amending the implicit fee formula, as suggested below, but that will not be enough. Operators will maintain their iron grip on programming and exclude independent voices using their monopoly power and the statutory presumption of their good faith, unless the Commission establishes standards for additional terms of carriage and fair dealing.

A. The Implicit Fee Formula

Affordability to channel lessees must be the critical criterion in setting maximum permissible rates if leased access is to fulfill any of the objectives of Congress in amending 47 U.S.C. § 532.

- Cable operators will treat the maximum permissible rate as the minimum rate.
- Cable operators have no incentive to make leased access rates affordable; to the contrary, by making leased access rates unaffordable, operators can effectively relieve themselves of all leased access obligations. (By and large, that is precisely why there is little or no leased access today, and why Congress found it necessary to amend the leased access provisions in the 1992 Cable Act.) Thus, the FCC cannot rely on free market forces to induce operators to lower rates if there are no takers (or takers die out) at the maximum permissible rate.

The current implicit fee formula yields prohibitive, unaffordable rates for any advertiser-supported leased access programmer on the basic or expanded basic tier.

- The formula improperly allows operators to double recover subscriber revenues from advertiser-supported leased access programmers on the basic and expanded basic tiers.
- The longstanding industry practice for advertiser-supported tier programmers -- a practice established by operators and programmers themselves and which leased access providers had no role in creating -- is that net

compensation runs <u>from</u> the cable operator <u>to</u> the programmer. The <u>only</u> exception is the case of must-carry broadcasters, which generally receive no compensation, but also pay <u>no</u> compensation to the cable operator. While home shopping channels generally pay compensation to cable operators in the form of a percentage of sales, they are not advertiser-supported channels and thus should be treated as a separate class of leased access programmers. (In any event, the "going rate" for home shopping channels should be a simple task. In fact, the "going rate" is about five percent of the channel's gross sales on the system, a level far below what Cablevision is demanding of KMR.)

- Some cable operators argue that leased access rates established in a manner similar to the FCC's current formula are not prohibitive except for "poorly-financed" or "non-viable" programmers. This argument is flatly contradicted by marketplace evidence:

  (a) If, as some operators argue, "adequately financed" and "viable" programmers could afford to pay leased access rates comparable to those yielded by the FCC's current rules, then the obvious question becomes: Why have cable operators, as rational profit-maximizers, not been charging those rates to the traditional (and presumably "viable"), non-leased access programmers on the operators' advertiser-supported tiers?

(b) In fact, the answer is obvious: No advertiser-supported tier programmer -- not even the "well-financed" and "viable" ones -- could afford to pay leased access rates as calculated by operators under the current implicit fee formula.

(c) The history of arrangements between operators and the established advertiser-supported programmers proves the point. The original advertiser-supported programmers in the late 1970s and early 1980s tried to survive solely on advertising revenues (although they, unlike leased access programmers, paid <u>no</u> compensation to operators for carriage). Even with free carriage, however, the traditional cable programming networks found it difficult to survive on advertising revenue alone. Indeed, the affiliate fees that operators pay to the established programmers today arose in the 1980s precisely because even the established programmers found that they could <u>not</u> survive on advertising revenues alone, but needed another revenue stream from operators.

(d) Rough calculations from public sources also prove the point. According to the <u>1994 Television & Cable Factbook</u>, CNN (presumably a "well-financed" and "viable" programmer) had nearly 57 million subscribers and received 24-33 cents/month/subscriber in affiliate fee revenues from cable operators. Using the FCC's implicit fee formula, Cablevision has been demanding that KMR pay rates of about $1.00/month/subscriber. If CNN had to pay those rates (and, if, in the process of course, CNN lost its 24-33 cents/month/subscriber in affiliate revenue), CNN would suffer a net loss from its present position of approximately $900 million, or <u>nearly a billion dollars</u>, per year. ($684 million of this figure would represent what CNN would have to <u>pay</u> operators under the implicit fee formula; the rest would be lost affiliate fee revenues.) Even a well-financed programmer like CNN could not possibly survive a $900 million/year shortfall from its present position. In fact, according to published reports, CNN's <u>total</u> revenue for the first half of 1992 was only about $260 million. That is <u>less</u> than the $684 million CNN would have to pay to obtain carriage at Cablevision's new leased access rates.

While the issue of whether leased access is remunerative to the operator is certainly relevant, what is remunerative to the operator cannot be assessed in a vacuum; rather, it can only be assessed in the context of (1) what the operator itself has considered to be sufficiently remunerative in the context of other channels of a similar class; and (2) the operator's costs. When those factors are considered in the context of advertiser-supported tier channels, it is clear that <u>any</u> monetary compensation by leased access programmers to operators, no matter how small (say zero to 5 cents/subscriber/month) would make leased access channels substantially <u>more</u> remunerative to the operator than any other advertiser-supported tier programmer.

- Since the operator pays an affiliate fee to every other advertiser-supported tier programmer, <u>any</u> net payment to the operator by a leased access programmer necessarily makes the operator's margin on the leased access channel <u>greater</u> than the margin it earns on any other non-leased access advertiser-supported channel on the tier.
- Moreover, in the case of an operator subject to rate regulation (on either the basic or expanded basic tier), the operator's maximum permitted rate is based

on the number of channels on the tier. As a result, carrying a leased access channel entitles the operator to charge a higher subscriber rate, even though, unlike all other channels on the tier, the operator pays nothing to the programmer. If the operator is allowed to charge the leased access programmer as little as a penny or a nickel/subscriber/month for the channel, the leased access channel becomes a "win-win" situation for the operator: The operator is entitled to charge a higher rate to subscribers for carrying the channel while simultaneously earning revenue from the leased access programmer, a double revenue stream that no other non-leased access advertiser-supported programmer provides to the operator.

- Cable operators have provided little in the way of data about the out-of-pocket costs they incur for leased access. What evidence there is suggests that the incremental cost must be negligible. The Center for Media Education and the Consumer Federation of America have submitted evidence to the Commission suggesting that the annual incremental cost to a cable operator of a full-time leased access channel is only $783.

B. Other Terms of Carriage

Using KMR as just one example, it is clear that operators have no desire to implement the leased access provisions of the Cable Act. They prefer to maintain total control over the programming on their systems because they are now in the business of selling programming. The Commission should make sure that its leased access rules do not facilitate operators' ability to maintain bottleneck control.

Cablevision's demand for financial information is a good example of the superficially reasonable requests an operator can make with the intent of delaying and eventually terminating negotiations. As a new venture, KMR was not in a position to provide such information -- KMR's financial status depends on receiving commitments on its investors, and its investors need to know that KMR's business prospects are sound before they can commit themselves. Since the single most important element to KMR's success is a leased access agreement with Cablevision, KMR and its investors cannot be expected to commit large sums to the project without knowing that they will have such an agreement. Still, KMR was prepared to overcome this hurdle and establish its good faith, so it asked Cablevision what level of financing would be adequate. Cablevision demonstrated its complete lack of interest in true negotiations when it responded "As much as you can get."

Cablevision knows perfectly well that KMR is a new venture and needs to have some assurance that it will be able to get its product to market before it can make a large investment. And KMR appreciates some of Cablevision's ostensible concerns over its staying power. But Cablevision never expressed any true willingness to negotiate, and such a cavalier reply can only be considered bad faith. Yet if it were not that term it would just as easily be another.

If Cablevision were truly interested in good faith negotiations, it would recognize this dilemma and demonstrate its desire to make a deal by showing a willingness to discuss some way of accommodating the concerns of both parties. Demanding such financial information and then not specifying what would satisfy its concerns is not normal commercial practice and is wholly unreasonable. Thus, even if KMR and Cablevision could agree on a leased access fee, there is no reason to believe that they would be able to reach an agreement, solely because of Cablevision's lack of good faith.

Other operators have also made it clear that revising the implicit fee formula will not be sufficient to promote the development of leased access, because they have raised arguments that are nothing more than an attack on having any leased access at all.

- Some operators have complained that cable operators "will have to remove existing programming to accommodate channel lessees," thereby causing "subscriber disruption." This is really nothing more than an argument that operators should have no leased access obligations at all.
- Some operators have said that "reduced leased access rates" are unnecessary for "program diversity" because there are already "over 70 cable networks" and "a variety of highly diverse local programming ventures." This position reflects a fundamental misunderstanding of the diversity principle underlying leased access. Absent leased access, all programming carried on the system is filtered through a single gatekeeper: the cable operator. Regardless of the number or subjective variety of the programming a cable operator chooses to carry, there can be no true diversity as long as there is a single gatekeeper making all programming decisions. The Supreme Court recognized as much in its recent _Turner_ decision.
- Some operators claim that low leased access rates would "subsidize" supposedly "unsuccessful" leased programmers and thereby exclude new, supposedly "more talented and ambitious," non-leased access programmers

(chosen, of course, by the cable operator). These same operators point out, however, that "it takes years to build a successful programming business, and programmers may not realize a profit for years." That may be true, but it proves the fallacy of the operators' argument: If it takes time for a programmer to develop even when it is unencumbered by leased access charges, how can operators seriously maintain that leased access programmers are unsuccessful when operators seek to impose conditions on them that they would never impose on embryonic non-leased access programmers?

Finally, we note that various non-leased access programmers and operators have urged the Commission to adopt new "going forward" incentives to encourage operators to add new programmers on their systems. Leaving aside the question of whether such incentives are actually necessary, we emphasize that it is critical that any such incentives include leased access programmers. Otherwise, the demonstrated tendencies of operators to discriminate against leased access programmers will be strengthened even further, making it virtually impossible for new leased access programming to break into the market.

CONCLUSIONS:

A. The Commission should reject operators' invitation to prolong the leased access rulemaking proceeding so that MSOs and established programmers can bury leased access programmers with mounds of filings. Because of the fragile financial status of leased access programmers, operators could accomplish indirectly through delay what the FCC has refused to allow them to do directly: destroy leased access programmers. While operators and established programmers complain that "going forward" rate issues must be resolved quickly, they overlook that leased access programmers have been waiting ten years for relief from operators' raw exercise of market power over them.

B. The FCC's current implicit fee formula makes no sense in the context of advertiser-supported tier leased access programmers. Indeed, none of the established, well-known cable programmers could possibly survive if, rather than receiving license fees from operators, they were charged leased access rates based on the implicit fee formula.

C. If leased access is to survive at all, the maximum permissible leased access rate for advertiser-supported tier leased access programmers must be negligible. KMR suggests that the maximum permissible rate should be in the range of zero to 5 cents per subscriber per month.

D. The Commission must also adopt rules establishing what constitutes good faith negotiation on the part of operators and what are reasonable terms of carriage. AS KMR's experience shows, unreasonable channel lease rates are only one tool operators can use to keep leased access programmers off their systems.

E. Finally, the Commission must not discriminate between leased access programmers and other programmers if it adopts new "going forward" programming incentives as part of its rate rules.